relevant to whether the local market in a particular state is open to competition. A case-by-case consideration of the relevance of certain aspects of local competition is not the same thing as imposing a checklist condition on approval of all applications.

2. Section 271 Relief Is Not Justified As An Inducement To IXCs To Enter The Local Markets.

BellSouth also presses here its argument that its application should be granted not on the merits but rather as a device to make long distance carriers more desperate to enter the local telephone markets.[183] This is sophistry. First, if entry barriers have not been lowered to the local phone markets, it doesn't matter how strong the incentive to enter might be -- by definition it cannot be actualized any faster because the barriers still stand. As Professor Marius Schwartz has observed, "the theory that local entry is delayed primarily due to CLECs' reluctance to trigger approval of BOC interLATA authority is not supported by the experience in states where non-BOC LECs already offer interLATA services.[184] Second, the real cause of slowed CLEC entry is not the imagined conspiracies of BellSouth but rather the various undertakings of the ILECs to resist through wide ranging means the erosion of the local telephone monopoly. The barriers erected by these undertakings have forced CLECs to adjust its local competitive plans.

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183 See BellSouth Br. at 119.

184 Schwartz Supp. Aff., filed in CC Dkt. No. 97-208 at ¶ 29.

In any event, there are a significant number of non-IXC affiliated CLECs that are fighting daily to break down the local bottleneck. Companies such as ACSI, Shell and KMC Telecom are engaged in business in Louisiana.[185]

Arguing that Section 271 relief should be granted because of the *absence* of local competition instead of *presence* of local competition turns the statutory scheme on its head. Indeed, BellSouth's true hostility to the prospects of local competition is in full evidence in its participation in a national advertising campaign funded through the United States Telephone Association. This campaign, promoting the incumbent local telephone company and designed to engender consumer mistrust of competitive entrants, reflects a clear belief by its sponsors, BellSouth among them, that competitive entry is not among the BOCs' (and thus BellSouth's) economic repertoire. Sprint has accordingly petitioned the Commission to investigate this conduct and consider it in its various statutory tasks, most especially 271 proceedings.[186] The underlying attitudes of the USTA members are highly relevant to the task of ascertaining the degree of BOC cooperation to facilitate entry.

As discussed above, Sprint believes summary dismissal is appropriate here. Sprint nevertheless responds to some of the factually and analytically flawed rhetoric contained in the

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[185] The presence of non-affiliated CLECs also demonstrates that any such IXC "plan" would be irrational, as it could never succeed.

[186] Petition of Sprint Corporation for Investigation and Relief (filed Sept. 10, 1997).

public interest section of the application. The prospect of BellSouth's entry into long distance will not predictably improve the competitive performance of this market. As discussed below, the likelihood of harm significantly and unambiguously outweighs the purported benefits.

B. The Effects on the InterLATA Market Also Require Denial of the Application.

1. BellSouth's Claims of Benefits to InterLATA Markets Are Entitled To No Weight.

BellSouth argues that its entry into the long distance market would be beneficial to consumers because, it asserts, the interLATA market is not performing competitively. BellSouth recycles a number of studies and affidavits produced for the South Carolina proceeding -- efforts already discredited.

The papers upon which BellSouth relies rest fundamentally upon factual assumptions proven false and thus rejected by Dr. Marius Schwartz, expert for the United States Department of Justice. As also set forth in the attached, "An Analysis Of BellSouth's Inflated Projections of Competitive Benefits And Consumer Welfare for Louisiana" by Marybeth Banks, BellSouth's papers use the wrong numbers and thus produce the wrong conclusions. First, BellSouth's proposed rates for interLATA service are in fact *higher* than those currently charged by Sprint.[187] It is thus difficult to see how BellSouth's interLATA

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[187] See Marybeth M. Banks, Director, Federal Regulatory Affairs Sprint Communications Company L.P., An Analysis Of BellSouth's Inflated Projections of Competitive Benefits And Consumer Welfare in Louisiana at 16-17 (1997) (attached at App. F).

entry would result in any consumer benefits at all. Second, BellSouth's attempt to show the benefits that will result from its interLATA entry by comparing SNET's in-region long distance rates with certain AT&T rates is unpersuasive. An examination of Sprint's long distance rates shows that there is little difference between SNET's prices and those of the industry generally.[188] Without any basis in actual market prices, the extravagant efficiencies promised by BellSouth and its experts collapse easily.

BellSouth also points to the consumer desire for one-stop shopping as one significant attraction to its interLATA entry. Sprint does not doubt the value of one-stop shopping; it has itself stressed this point in its advocacy to this Commission. But it is precisely the high value placed on this which counsels *against* BOC entry until the local market opportunities have been made available. As explained by Professor Shapiro, marketing economies here may be significant, and thus public policy dictates that opportunities to capture them be available on reasonably comparable terms to all possible participants. But so long as the local market is kept closed by BOC behavior, there is no opportunity for any carriers other than the BOC to offer one-stop shopping. And, significantly, entry into long distance, already well established, is readily and quickly achieved by reselling existing capacity. Thus, interLATA competition is much less of a concern and much less of an opportunity than non-

[188] Id. at 2-8.

existent local entry at this time. It is thus preferable to allow for local market entry opportunities first, which can thereafter be quickly followed by additional entry into long distance markets.

2. Predictable Harm To The InterLATA Market Is Alone Sufficient Reason To Deny The Application.

Without adequate competition established at the local exchange level, there will be no market disciplining effect on BellSouth to refrain from anticompetitive conduct in the interLATA market.[189] Both discrimination and cross-subsidization remain serious threats to the interLATA competitive market.

a. Discrimination.

As described by the former FCC Chief Economist Joseph Farrell:

> The BOCs' incentives and ability to discriminate against rivals in long-distance -- to take the most prominent example of *MFJ* prohibitions -- depend on their market power in the local bottleneck. If we can open up the bottleneck and implement vigorous competition there, then BOCs will have little or no incentive to raise the costs of their long-distance partners -- and if they do so, those long-distance

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[189] As noted earlier, BellSouth concedes that the FCC may evaluate the strength of local competition as it effects the long distance market. BellSouth Br. at 86. It goes on to suggest that the FCC is bound to conclude that safeguards will be sufficient to protect against the risks to the interLATA market. But the FCC is not bound by an amicus brief it once filed; indeed, it is free to change its institutional decisions where it can articulate a rational basis for doing so. See Motor Vehicle Manufacturers Assoc. of the United States v. State Farm Mutual Automobile Insurance Co., 463 U.S. 29 (1983). As discussed above, the changes brought about in the regulatory schema and the Eighth Circuit's dramatic reversal alters fundamentally earlier conclusions made by the agency on the likelihood of misconduct and the adequacy of safeguards.

> carriers and their customers will have other choices, so the harm to consumers will be limited. Thus, when there is enough competition in what is now the local bottleneck, it will make good sense to let the BOCs into complementary businesses such as manufacturing and long distance.[190]

While regulators will try to prevent this type of misconduct, the anticompetitive opportunities available to BellSouth will be substantial. It need only adversely adjust any one of large numbers of access "details" and thereby seriously disrupt the interLATA market.

BellSouth could also mask its behavior in ways that will be difficult to remedy.[191] Further, the opportunities for discrimination remain substantial as BellSouth insists on OSS interfaces that require human intervention (and thus discretion) rather than electronic interfaces. As explained above, Sprint's experience in Florida confirms that BellSouth's OSS is simply incapable of supporting local competition. Finally, trying to "undo" the harm flowing from discriminatory conduct will likely be far costlier and more complex than simply avoiding them in the first place.

One of the more misleading arguments set forth by BellSouth has been to try to identify the experience of BOC competition in

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190 Farrell, Joseph, Creating Local Competition, 49 Fed. Comm. L.J. 201, 207-08 (Nov. 1996).

191 The FCC's former Chief Economist has stated that "[t]hese problems are hard to regulate away, because the withdrawal of cooperation from rivals may be subtle, shifting, and temporary, but yet have real and permanent effects. . . ." See id. at 207.

the New York-New Jersey corridor to show that discrimination is unlikely. The example in fact suggests the opposite proposition. BellSouth notes that Bell Atlantic was able to achieve a "mere" 20% market share in the toll corridor traffic, thereby suggesting the presence of benign competition and nothing else.[192] What is omitted from this neat example is the fact that this market share was achieved *notwithstanding the fact that none of this traffic was presubscribed to Bell Atlantic,* it is comprised of dial-around minutes.[193] That such a large fraction of the traffic could be obtained through such a crude dialing mechanism in fact suggests such a powerfully successful degree of marketing as to raise suspicion.

b. Cross-subsidization.

Contrary to BellSouth's contention,[194] regulation has not removed the BOC's incentive and ability to engage in anticompetitive conduct similar to that found under rate-of-return regulation. This is because price cap regulation still considers underlying ILEC costs. The FCC's price cap scheme imposes reporting requirements for, and periodic agency reviews of, BellSouth's profit levels, i.e., rates of return. Thus, the reporting requirements and periodic reviews continue cost-based

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192 See BellSouth Br. at 93.

193 See United States v. Western Elec. Co., 569 F. Supp. 1057, 1110 n.230 (D.D.C. 1983).

194 See BellSouth Br. at 85-96.

regulation. As such, they induce BellSouth to misallocate costs from competitive services to the noncompetitive side.[195]

In theory, these unwholesome incentives would not exist under a "pure" price cap regime. Under pure price caps, initial rates would be based on "true economic cost" and would not thereafter be altered in response to reported costs. The Commission has not adopted a pure price cap plan, however, given public policy goals other than the achievement of maximum efficiency.[196] Attention to BellSouth's performance, measured in terms of its rate of return, ensures that over time rate levels do not become unjust or unreasonable, either in the political or legal sense. This "feedback" mechanism retains the unwholesome incentives embedded in traditional rate-of-return regulation.[197]

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195 See Amendment of the Commission's Rules to Establish Competitive Service Safeguards for Local Exchange Carrier Provision of Commercial Mobile Radio Services; Implementation of Section 601(d) of the Telecommunications Act of 1996, WT Docket No. 96-162, *Report and Order* at ¶ 60 (rel. Oct. 3, 1997) (the recent revision of the FCC's price cap rules substantially reduces, but does not eliminate entirely the BOC's incentive to misallocate costs, since the price caps regime still retains a rate-of-return aspect in the low-end adjustment mechanism. Furthermore, periodic performance reviews to update the X-factor could replicate the effects of rate-of-return regulation, if based on a particular carrier's interstate earnings rather than industry-wide productivity growth.) (citations omitted).

196 From its inception, the FCC's price cap plan has explicitly recognized that any plan must not ignore the Commission's obligation to ensure just and reasonable rates. See Policy and Rules Concerning Rates for Dominant Carriers, *Second Report and Order*, 5 FCC Rcd 6786, 6801 ¶ 121 (1990).

197 The periodic adjustment of productivity factors, and the attending reliance upon an examination of ILEC costs, provides an example of the "feedback mechanism." The Commission has also committed to a performance review in "about two years" so that the Commission can "make any

The Commission has also refused to limit its discretion to make exogenous rate adjustments to ensure that rates permit recovery of historic costs.[198] Finally, to avoid regulatory confiscation, the Commission has also retained the low-end adjustment mechanism that ensures that no price cap LEC will earn less than a 10.25% interstate rate-of-return.[199]

The improvements brought by price caps as actually implemented do not include elimination of the regulated firm's incentive to shift costs.[200] Until and unless the FCC's statutory mandate is changed, its price cap regulation will promote the same incentive and ability to cross-subsidize as exists under rate-of-return regulation.

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necessary adjustments before the price cap plan leads to unreasonably high or low rates." See In the Matter of Price Cap Performance Review for Local Exchange Carriers, CC Dkt. No. 94-1, *Fourth Report and Order* at ¶ 166 (rel. May 21, 1997). While the Commission emphasized that it will, to the extent possible, focus on "industry-wide performance or other generic factors, rather than adjustments that are tied to a particular price cap incumbent LEC's interstate earnings . . . ." See id. at ¶ 167, the ultimate determinant of "reasonableness" must remain a firm's costs. Until this legal requirement changes, the FCC's regulatory scheme will remain essentially the same.

198 See id. at ¶ 175 (noting that exogenous adjustments may be necessary to permit LECs to recover "embedded" costs).

199 See id. at ¶ 127.

200 In upholding the FCC's price cap regulations, the D.C. Circuit acknowledged that "price cap regulation cannot quite live up to its promise. . . . Obviously no such formula can be perfect, so ultimately the Commission must check to see whether the cap has gotten out of line with reality. The prospect of that next overview may dampen firms' cost-cutting zeal." See National Rural Telecom Ass'n v. FCC, 988 F.2d 174, 178 (D.C. Cir. 1993).

Finally, the FCC's structural and accounting safeguards do not eliminate the opportunity to act on the incentives created by rate regulation. The Commission explicitly acknowledged in its Non-Accounting Safeguards Order that its rules leave BOCs with opportunities to misallocate the costs of their Section 272 affiliates.[201] Far from requiring complete separation of BOCs and their Section 272 affiliates, the Commission permitted substantial integration. For example, the Commission permitted sharing of marketing and administrative services and the offices and equipment associated with those activities.[202] The Commission also permitted the operating company and its Section 272 affiliate to obtain services from the same outside suppliers.[203] Undetected cross-subsidy is therefore a recognized risk despite regulatory safeguards.

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[201] In establishing the structural safeguards applicable to BOC Section 272 affiliates, the Commission balanced the inefficient incentives with the increased economies of scale and scope created by the integration of BOCs and their affiliates. As the Commission explained,

> [w]e believe it is consistent with both the letter and purposes of section 272 to strike an appropriate balance between allowing the BOCs to achieve efficiencies within their corporate structures and protecting ratepayers against improper cost allocation and competitors against discrimination.

Non-Accounting Safeguards Order at ¶ 167.

[202] See id. at ¶ 178. In doing so, the Commission stated that "[w]e recognize that allowing the sharing of in-house services will require a BOC to allocate the costs of such services between the operating company and its section 272 affiliate and provide opportunities for improper cost allocation . . . ." Id. at ¶ 180.

[203] See id. at ¶ 184.

c. Access Charge Reform Is A Prerequisite to Entry.

Additionally, interLATA entry cannot be authorized until access reform is fully implemented. Competition cannot produce the hoped for efficiency gains for consumers if regulation continues to distort the market. In its 1997 Access Charge Order, the Commission did remove some of the inefficiencies in the interstate access rate structure. But while it has acknowledged that current access charge levels greatly exceed costs,[204] the Commission's "market-based" approach to lowering access charges is critically dependent on competition in access that is yet to develop.[205]

The inflated access charges that Sprint and other IXCs must pay over to BellSouth and to other BOCs create indisputable problems if the latter are allowed to compete for interLATA business. BellSouth has a clear, artificial cost advantage in obtaining the access services essential to the provision of interLATA services.

As Professor Shapiro has explained, BellSouth will be able to compete for incremental toll calling by imputing the true cost of access; everyone else will be competitively disadvantaged by

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204 See In the Matter of Access Charge Reform, CC Dkt. No. 96-262, *First Report and Order* at ¶ 29 (rel. May 16, 1997) (describing effects of overallocation of intrastate costs to the interstate rate base).

205 See id. at ¶ 263. BellSouth has not produced evidence of any amount of access competition sufficient to restrain its own pricing. In addition, the FCC has not even established specific rules for its market-based approach.

the need to include the inflated access costs charged by BellSouth. This advantage is by no means rectified by regulatory requirements of separate subsidiaries and imputation, since economic judgments will be made for the enterprise as a whole.

In the Access Charge Order, the Commission concluded that price squeezes imposed by vertically integrated LECs on their long distance competitors were unlikely.[206] In reaching this conclusion the Commission assumed that, if a LEC attempted such a price squeeze, an IXC could bypass the LEC network by purchasing UNEs. But this form of bypass is unavailable in Louisiana because of the deficiencies in BellSouth's OSS and the legal uncertainties regarding the status of UNEs in general. Thus, the very condition the FCC has deemed necessary to preclude a price squeeze is absent here.

The opportunities for BellSouth to discriminate and cross-subsidize hurts not only competitors, but consumers who otherwise reap the benefits of the competitive process. Local ratepayers are forced to subsidize the competitive ventures of the BOCs. Second, consumers of competitive interLATA services are saddled with less efficient products and services because the market share of more efficient firms has been displaced by BellSouth -- not by better service but by misconduct.

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[206] See id. at ¶ 278.

CONCLUSION

For the foregoing reasons, BellSouth's application must be denied.

Respectfully submitted,

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Dated: November 25, 1997

** The following materials are not included in Sprint's diskette filing. They are, however, on file with the Commission: App. A, C, and D to Sprint's Petition to Deny, and App. A-H of Closz Affidavit.

CERTIFICATE OF SERVICE

I, Catherine M. DeAngelis, do hereby certify that on this 25th day of November, 1997, copies of the foregoing "Petition to Deny of Sprint Communications Company L.P." were mailed, first class postage prepaid, unless otherwise indicated, to the following parties:

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Second Annual Report

Competition in the Commercial Mobile Radio Services

Federal Communications Commission

602754

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C.

In the Matter of	)
	)
Implementation of Section 6002(b) of the Omnibus Budget Reconciliation Act of 1993	)))
	)
Annual Report and Analysis of Competitive Market Conditions With Respect to Commercial Mobile Services	))))

SECOND REPORT

Adopted: March 6, 1997 **Released: March 25, 1997**

By the Commission:

602756

CHARTS

TABLES

APPENDIX

thus generating additional per minute revenues. For paging subscribers seeking only an inexpensive messaging service and no voice services, based on current pricing levels, it is unlikely that they will choose cellular or broadband PCS service incorporating this feature as a substitute for their current paging service. The gap between the cost of basic paging service and the lowest priced cellular or broadband PCS service plan inhibits such a leap for the time being. On the other hand, the thirty percent of cellular subscribers who also have pagers may view such a combined offering as a substitute for maintaining separate paging and cellular service. Therefore, the capabilities of newer technological developments may induce increased competition for subscribers seeking a combined voice and messaging service option.

D. Competition with Wireline Telecommunications Providers

The Commission will continue to gauge the extent to which wireless services are a complement to or a substitute for wireline services. Wireless services do not yet approach the ubiquity of wireline telephone service, but there are a number of trends apparent in the increased use of wireless telephony that may point to the eventual use of wireless telephony as not just a supplementary communications tool to traditional wireline telephone service but as a substitute for such service. Our analysis in this Report will focus on the extent to which the mass market is adopting wireless telephony as a substitute for wireline.

Thirteen percent of Americans are using wireless telephony as a complement to wireline communications.[247] Moreover, a recent case decided by the Wireless Telecommunications Bureau illustrates the degree to which cellular service may be treated as a substitute for conventional wireline telephone service, from a technical and operational perspective.[248] In that proceeding US West sought a waiver of the Commission's Rules to enable US West to provide cellular service to customers "who are without access to dial-tone service while they await installation of landline telephone service."[249] The Bureau, in granting the waiver, found that its "decision will serve the public interest by permitting subscribers experiencing delays in obtaining landline telephone service to gain access to the public switched network by means of temporary cellular service."[250] Thus, the *US West Order* illustrates a case in which cellular service, in a very limit-

[247] For some consumers, wireless telephony may already compete with wireline service as an alternative means of obtaining a second telephone line in the home. However, we have no information to ascertain the extent, if any, to which this substitution is occurring.

[248] Request of US West Communications, Inc., for a Limited Waiver of Section 22.903 of the Commission's Rules, DA 96-605, Wireless. Telecom. Bur., released Apr. 17, 1996 (*US West Order*).

[249] *Id.* at para. 6.

[250] *Id.* at para. 20.